Spheria Emerging Companies Limited
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ACN 621 402 588

14 January 2020

Company Announcements
ASX Limited
Exchange Centre
20 Bridge Street
Sydney NSW 2000

Dear Sir/Madam,

Spheria Emerging Companies Limited (ASX:SEC) – Monthly Investment Update

Please find attached a copy of the investment update for the month ending 31 December 2019.

Yours sincerely,

Calvin Kwok
Company Secretary

ASX: SEC

Investment Update

As at 31st December 2019

Spheria Emerging Companies Limited
ACN 621 402 588

Pre-tax net tangible assets[4]

$2.097

Company[7] performance p.a. (since inception)

4.7%

Company Facts

Investment Manager	Spheria Asset Management Pty Limited
ASX Code	SEC
Share price	$1.79
Inception date	30 November 2017
Listing date	5 December 2017
Benchmark	S&P/ASX Small Ordinaries Accumulation Index
Management Fee	1.00% (plus GST) per annum[1]
Performance Fee	20% (plus GST) of the Portfolio's outperformance[2]
Market Capitalisation	$115m

[1] calculated daily and paid at the end of each month in arrears
[2] against the Benchmark over each 6-month period subject to a high-water mark mechanism

Commentary

The Company's pre-tax NTA declined 0.5% in December. This represented underperformance of 0.2% compared to the S&P/ASX Small Ordinaries Accumulation Index.

The market continues to be driven by highly speculative forces due to synchronised monetary stimulus provided by very accommodating central banks. During the quarter, the Fed increased its balance sheet to counter short term funding spikes in the US repo market. This alleviated stress in the overnight lending market but has also fed asset price strength particularly in global sharemarkets. The rise of passive and quantitative strategies has resulted in less efficient markets in which participants are exploiting a lack of qualitative analysis. We think this may end badly for clients invested in these types of strategies. Many of the companies that have had meteoric rises lack substance and therefore durability or are simply duplicit in nature, making it a very challenging market to outperform when you are fundamentally based.

Major contributors to performance in December were:

- Bega Cheese (BGA.ASX) – which rallied 14% after a significant share price decline in the past year. The company has been beset by extreme external factors with the drought impacting milk supply, leading to higher farm gate milk prices which are difficult to pass on given the structure of the domestic grocery channel. The tragic bushfires more recently will further impact milk supply in certain regions. We see Bega as a vital pillar in many of these regional communities and will continue to support them from a capital perspective. We expect it to be a challenging period for the company, but it is nothing compared to the personal toll the drought and bushfires have had on those affected.
- Village Roadshow (VRL.ASX) – gained 18% in December after receiving a non-binding indicative takeover offer from a private equity group at a premium to the undisturbed share price. We believe there is significant value in the underlying asset portfolio at VRL that could be realised through a breakup. Furthermore, we think the business can be run more efficiently given the cost structure has always looked very heavy from a corporate office perspective and even divisionally. While the underlying portfolio is high quality and enjoys excellent market positions (particularly exhibition and themeparks) this lack of cost control and some poor capital allocation decisions by the group has hampered group performance in the past.

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- Mount Gibson (MGX.ASX) – bounced 19% on the back of a resurgent iron ore price. Having taken profits at higher levels, we increased our weighting on the dip. To date, the re-commission of Koolan Island has tracked largely in line with expectations.

Major detractors to performance in December were:

- Class (CL1.ASX) – which retraced 11% on little news flow after a significant surge in the share price over the last few months. With growth now stabilising at reasonable levels in the core SMSF product and the near-term entry (June) into the family trust market, we believe the long-term outlook is very promising. Whilst the increased spend on building a tax engine for family trusts has degraded short term earnings, we believe the payoff could be significant given our enquiries indicate that incumbent products have not been purposefully designed and are therefore ripe for displacement.
- Mortgage Choice (MOC.ASX) – like CL1, fell 10% in December on little new news. The outlook for the housing market has demonstrably improved since May 2019 due to monetary stimulus, a relaxation of APRA lending standards and the removal of the threat of Labor's proposed changes to CGT and negative gearing policies. MOC is currently enjoying a significantly improved macro environment after a sharp downturn in approvals that was quantitatively worse than the GFC during calendar 2018 and the first half of 2019. We also believe recruitment will be easier for MOC given improved commercial arrangements implemented last financial year and a benign regulatory environment where the existential threat to mortgage brokers posed by the Hayne Commission recommendations is now firmly off the table, which had been a huge deterrent for anyone pondering entering the industry.
- Healius (HLS.ASX) – fell 10% after providing a weaker than expected profit update in late November, which has continued to weigh on the share price. It's easier to be dismissive of HLS given the challenges facing the business in particular the GP model/division, however, we believe there is sufficient strength in the pathology assets to underpin the group valuation. This means risk is skewed to the upside if they can improve returns in the GP division and/or divest non-core assets to buyers that can generate synergies.

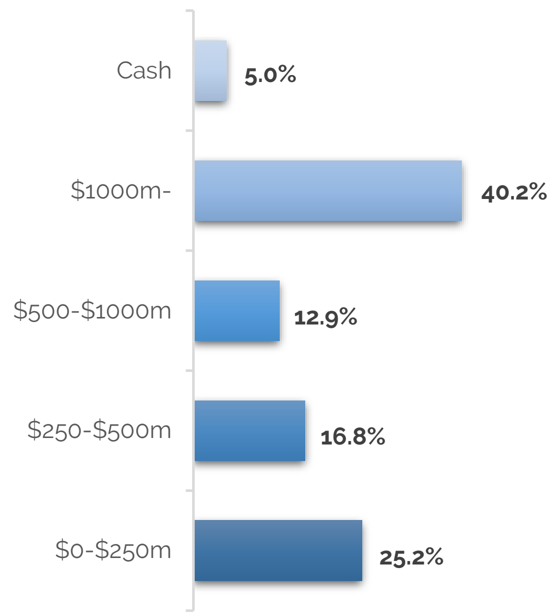
We remain cautious on the outlook given the lofty valuations ascribed to companies that either generate very little profit or are deliberately burning cash with no obvious path to profitability, this is a dangerous game, in our view. We prefer to buy companies that have sound market positions that generate predictable and durable cash flow, and that have relatively attractive valuations. We are still finding opportunities on this front, that we believe will generate solid returns for our clients at relatively lower risk.

Top 5 Holdings

Company Name	% Portfolio
Class Limited	5.1
Blackmores Limited	4.6
Adelaide Brighton	4.5
Fletcher Building	4.5
Platinum Asset	4.5
Top 5	**23.2**

Source: Spheria Asset Management

Market Cap Bands



Source: Spheria Asset Management

Net Tangible Assets (NTA)[3]

Pre-tax NTA[4]	$2.097
Post-tax NTA[5]	$2.137

[3] NTA calculations exclude Deferred Tax Assets relating to capitalised issue cost related balances and income tax losses

[4] Pre-tax NTA includes tax on realised gains/losses and other earnings, but excludes any provisions for tax on unrealised gains/losses

[5] Post-tax NTA includes tax on realised and unrealised gains/losses and other earnings

Performance as at 31st December 2019

	1m	6m	1yr	2yr	Inception p.a.[6]
Company[7]	-0.5%	4.7%	17.3%	3.3%	4.7%
Benchmark[8]	-0.3%	3.9%	21.4%	5.3%	6.5%

Past performance is not a reliable indicator of future performance.

[6] Inception date is 30th November 2017

[7] Calculated as movement in Company's pre-tax NTA (which includes tax on realised gains/losses and other earnings, but excludes any provision for tax on unrealised gains/losses), assuming the re-investment of any dividends paid by the company

[8] Benchmark is the S&P/ASX Small Ordinaries Accumulation Index